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National Credit Union Administration
regcomments@ncua.gov

Re: Comments on Golden Parachute and Indemnification Payments

Greetings:

We provide the following comments regarding the proposed new part 750 of the National Credit Union Administration's (NCUA's) regulations.

We applaud the proposed rule and believe it will limit the improper disposition of the assets of federally insured credit unions ("FICUs") that are troubled. However, we believe that the changes suggested below would minimize the interference with reasonable and necessary compensation arrangements of non-troubled FICUs.

1. Vesting at Termination of Employment. Typical nonqualified deferred compensation plans (DCPs) or supplemental retirement plans (SRPs) accrue benefits over several years and then vest if the participant remains employed to a specified date. The benefits also vest and become payable if, prior to the specified vesting date, the participant dies, becomes disabled, or is involuntarily terminated without cause. These provisions assure the participant that the FICU will pay the benefit if the participant is unable to complete the required service through no fault of his or her own.

   Section 750.1(d)(3)(iii) provides that to be a bona fide deferred compensation plan that is exempt from the rule, the institution-affiliated party (IAP) must have a vested right "at the time of termination of employment" to the payments. This seems to leave open the issue of whether a participant who vests *by virtue of* the termination (e.g., an involuntary termination without cause) would qualify. We recommend that this concept be clarified by revising the language to provide that the exemption covers IAPs who are vested "at the time of, or by the occurrence of, the termination of employment." We believe that the other qualifications to be a bona fide deferred compensation plan (e.g., plan in effect for at least one year and ignoring amendments made within one year before the event) will still operate to prevent abuses.

2. Nondiscriminatory Severance Plans. A further exemption from the rule is provided for "nondiscriminatory" severance pay plans. As we understand the proposed rule, to qualify for this exemption, the plan must:

- Cover all employees (subject to reasonable and customary eligibility requirements)
- Cover at least 33% of all employees in any sub-groups within the plan (i.e., not have more than three levels of benefits)
- Not have more than a 10% variance between levels of benefits
- Limit benefits to no more than 12 months of salary

To attract and retain key management, particularly in FICUs posing significant market and management challenges, FICUs often have to offer key management employees greater levels of severance benefits (e.g., 12 to 18 months) than is competitive for other FICU employees. The increased severance gives management the freedom to undertake strong initiatives required to meet the challenges. Absent the protection, key management is less likely to accept the challenge.

Under the standards proposed, FICUs would have to increase severance benefits for a broader group of employees just to be able to offer the required key employee severance needs yet still meet the proposed rule's definition of nondiscriminatory. We believe a few modifications to the nondiscriminatory severance pay plan definition would restore some of the necessary flexibility without opening the doors to the undesired golden parachute payments.

With respect to sub-groups consisting of 33% of all employees, we recommend two modifications. First, it would be easier to administer and monitor this requirement if rather than referring to 33% of all *employees*, the standard was 33% of all *plan participants*. This standard would exclude from the determination those who have not met the permitted eligibility requirements and facilitate the counting.

Second, and more substantively, the 33% requirement would treat large FICUs differently than small FICUs – a FICU with 300 participants would have to include 100 in each level, whereas a FICU with 30 participants would only have to include 10. This could lead the large FICU to provide severance benefits above industry standard for a large number of participants just to meet the minimum requirements of the key employees. We recommend that the rules still limit the number of permissible sub-groups to three, but that each level be required to have a number of participants equal to *the lesser of 33% of all participants or 10*.

Finally, we recommend a greater permitted variance between levels, and that the variance not be determined as between each level, but rather as between the highest and lowest levels. We believe a 50% permitted variance would suffice. For example, the plan could provide one month of severance for each year of service up to eight months for rank and file, and up to 12 months (i.e., 8 times 1.5) for the executive group. The plan could also then provide a middle group anywhere between the lowest and highest levels of benefits.

3. Grandfathered Arrangements. The preamble to the proposed rule provides that the rule will apply to all new employment contracts entered into on or after the date the rule is finalized, and to "existing contracts that are renewed or modified in any way after the final rule's effective date." We believe a few modifications will assist the industry in applying these rules effectively.

   First, the reference to "employment contracts" could be interpreted narrowly not to include DCPs, SRPs or severance arrangements that are documented in stand-alone agreements or plans rather than in broader employment agreements. We believe a better approach would be for the rules to apply to "arrangements" that are in effect as of the effective date of the final rule. This would allow, for example, an SRP contained in an employment agreement to retain its grandfathered status notwithstanding changes to the employment agreement that do not affect the benefits payable under the SRP.

   Next, there are modifications to arrangements that become necessary over time but that do not affect the economics. We recommend that such non-substantive and non-economic changes be excluded from the modification test. The concept of "material modifications" is common in tax law effective date provisions and could serve well here. (*See, e.g.*, 26 CFR § 1.409A-6 (effective date provisions for Section 409A of the Internal Revenue Code); 26 CFR § 1.61-22(j)(2) (effective date provisions for split dollar regulations).) Using a material modification standard would allow for technical updates to documents (e.g., change in name of the FICU, change in the participant's title or changes to comply with tax or other regulations) without causing loss of "grandfathered status" for purposes of part 750.

   Another aspect of the material modification testing under tax law is that *reductions* in benefits are not treated as material modifications. This was the case with the material modification standard used under Section 457 of the Internal Revenue Code when extended to tax-exempt organizations in 1986. More recently, reductions in benefits are not material modifications for purposes of Section 409A of the Code. (*See, e.g.*, 26 CFR § 1.409A-6(a)(4)(i) ("The reduction of an existing benefit is not a material modification.") A similar application under part 750 would allow FICUs to reduce benefits as market and other conditions warrant without losing grandfathered status.

4. Pre-Troubled Agreements. We understand that the intent of the new rules is that the restrictions apply only to agreements entered into when the credit union is troubled. Agreements in place prior to the FICU becoming troubled would be exempt from the restrictions, and payments under such agreements could be made even after the FICU becomes troubled. We support this vision of the rules' application.

To assure that result, we recommend that Section 750.0(c) be redesignated (d), and that a new Section 750.0(c) be added, as follows:

(c) This part does not apply to payments made when the FICU is not troubled, or to payments by a troubled FICU under arrangements that were in place before the FICU became troubled.

We would be happy to discuss any of these comments with you in more detail. Thank you for your consideration.

Sincerely,

SHERMAN & PATTERSON, LTD.

Kirk D. Sherman

KDS/sj